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**William Kennard
General Counsel
Federal Communications Commission
1919 M St. N.W. -- Room 614
Washington, D.C. 20554**

Dear Mr. Kennard:

On behalf of AT&T, MCI, LDDS WorldCom and CompTel, attached is a legal analysis of the key provisions of the Telecommunications Act of 1996. Thank you again for an opportunity to present our views at the March 15, 1996 forum hosted by your office. We hope that the forum helped you and your staff to crystalize the legal issues facing the Commission. From our perspective, the forum certainly helped elevate the level of debate.

If you or your staff has any questions about the attached document, we are available to answer your questions at your convenience.

Sincerely,

Mary L. Brown
Mary L. Brown

[Faint handwritten notes and a circular stamp]

INTERCONNECTION, UNBUNDLING AND ACCESS:

**CREATING FULL SERVICE COMPETITION
UNDER THE TELECOMMUNICATIONS ACT OF 1996**

AT&T, MCI, LDDS WorldCom and CompTel

March 1996

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Sections 251 and 252 of the Telecommunications Act of 1996 provide the framework for establishing the conditions necessary for local competition to succeed, if those statutory provisions are correctly implemented. They represent the United States Congress's decision to create legal requirements that will allow vibrant, efficient and effective competition to develop in all sectors of the telecommunications industry. This paper provides a roadmap for implementation of some of the key statutory provisions.

I. CORRECT FCC IMPLEMENTATION OF THE ACT IS CRITICAL TO COMPETITION AND TO CONSUMER CHOICE

The recently enacted federal legislation has transformed the telecommunications landscape. By setting the stage for local competition and RBOC entry into the interLATA market, the legislation has brought the telecommunications market to a paradigm shift as significant as the divestiture of AT&T: the emergence of full service competition. A full service market will see the end of conventional distinctions between "LECs" and "IXCs." In its place, most carriers will offer consumers a complete package of services, including local exchange service, exchange access service, and toll.

If a large portion of the market prefers to obtain all voice services as a package -- and

there is general consensus, all else being equal, that this is the case -- then the absence of competition for any element (i.e., exchange service) would distort competition for all services that are sold as a package. If a competitive full service marketplace is to develop, this Commission must ensure that barriers to offering all the key ingredients of the basic package -- i.e., local and long distance services -- are comparably low so that consumers benefit from real competitive alternatives for local service and toll services.

For the RBOCs, it is an easy matter to provide long distance service. The RBOCs will be able to provide long distance service over their own ratepayer-financed networks and those that have already been constructed by facilities-based long distance carriers. The RBOCs will be able to order full service for their customers through automated interfaces that are capable of handling many thousands of order changes a day, all at rates reflective of the highly competitive carrier's carrier market. Long distance services have long been available for resale, and the facilities-based carriers have standard procedures in place for serving other carriers seeking to lease capacity. Recent contracts by several RBOCs to obtain long distance capacity for out-of-region and cellular long distance operations show how easy it is for them to turn up long distance service.

The provision of competitive local exchange services stands in stark contrast. There is only one local exchange network today -- that of the incumbent LEC. At present, all LEC competitors are dependent on the ability to use that existing network -- in part or in whole -- in order to provide local exchange service comparable to the LEC. To meaningfully compete, the LEC competitors must have access to that network at the same price as the incumbent, i.e., the direct economic cost of such access.

It is critical that competitive telecommunications carriers obtain access to RBOC networks under Section 251 to originate and terminate calls on the same basis as the RBOC does itself. In addition, depending upon the business plan of the telecommunications carrier, a carrier is likely to be dependent on the incumbent LECs for termination of many long distance calls, and in many cases, for the origination of long distance calls, as well. It is commonly understood that current interstate access rates are well above economic cost — indeed they are seven times economic cost. Yet economic cost is the price the RBOCs would themselves face in providing their own long distance services. Although the Act mandates that the RBOC provide long distance through a separate subsidiary, and that the subsidiary buy access at tariffed rates, the only cost that comes out of the RBOCs' pockets are the economic costs of access. Prior to RBOC entry into the interLATA market, this great disparity in access rates must be eliminated. If it is not, it will have serious competitive consequences. Access must be brought down to economic cost before the RBOCs are to be allowed to provide interLATA services.

The federal legislation contains the framework necessary for the Commission to develop rules that can make the LEC network available at cost-based rates to all competing service providers. The legislation:

- provides for broad unbundling of LEC network elements at any technically feasible point on terms and conditions that are just, reasonable, and nondiscriminatory, and provides for rates at cost [Sections 251(c)(3); 252(d)(1)(A)];
- requires LECs to offer these elements in a manner that permits other carriers to combine them to offer any telecommunications service [Section 251(c)(3)];
- requires LECs to provide interconnection (including exchange access) to telecommunications carriers at any technically feasible point, and to provide rates at cost [Sections 251(c)(2); 252(d)(1)(A)]; and

- requires LECs to make retail services available for resale at wholesale rates [Section 251(c)(4); 252(d)(3)].

Each of these provisions also must be satisfied before the RBOCs can be permitted to provide interLATA service, under the Act's checklist provisions. Section 271(c)(2)(B).

The Act must be correctly implemented, despite political pressure not to write regulations implementing the statutory provisions. We agree with ALTS that the 1996 Act is not self-excusing. If the Act is correctly implemented, consumers will have more choices, price competition, and more rapid technological deployment.

II. KEY PROVISIONS OF THE LEGISLATION

Most long distance carriers will seek to enter local markets under the interconnection and unbundling requirements of Sections 251 and 252, using LEC network elements and/or services substantially or in whole to create their own service offerings to customers. In some cases, these carriers will construct limited loop, local switching, and/or local transport facilities. A policy goal that favors facilities-based competition must include the ability of telecommunications carriers to use a LEC's facilities as they build out their networks. Of course, some long distance carriers may continue to rely on incumbent LEC or CLEC facilities and/or services to originate and terminate toll traffic. Regardless of their business plans, when a carrier originates or terminates a toll call to an end user who is not one of its local customers, it will need to buy access from another carrier.

A. Network Unbundling

The "unbundled access" requirement creates an affirmative duty on the incumbent LEC to provide to "any requesting telecommunication carrier" nondiscriminatory and unbundled access to the LECs network elements for the purpose of offering "a telecommunication service." Section 251(c)(3). A "telecommunications carrier" is defined as any carrier offering telecommunications services (except aggregators). Section 153(a)(49). Telecommunications carriers providing long distance clearly qualify as "telecommunications carriers," as that term is used in the statute. A "telecommunications service" is defined as "the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, regardless of facilities used." Section 153(a)(51).¹

The new Act also requires incumbent LECs to "... provide such unbundled network elements in a manner that allows requesting carriers to combine such elements in order to provide such telecommunications service." Section 251(c)(3). This provision makes it clear that not only must incumbent LECs unbundle their networks, they also must do so in such a way that other carriers may combine all the unbundled elements in any fashion in order to offer their own telecommunications services. Because competing carriers will be able to order unbundled network elements in any combination or configuration, they will be able to provide service immediately over LEC network facilities while they construct alternate local facilities where economically justified. Having paid the economic cost of the network in their purchase of these elements, as provided in Section 252(d)(1)(A), requesting carriers can use these unbundled network elements to provide both local exchange service (including vertical features) and

¹ The Joint Explanatory Statement specifically includes "competitive access service" in the definition of a telecommunications service. See Telecommunications Act of 1996, Conference Report No. 104-458, January 31, 1996 at 114, 116.

exchange access in competition with the LEC.

The federal legislation also defines "network element" broadly to include :

... a facility or equipment used in the provision of a telecommunications service. Such term also includes features, functions, and capabilities that are provided by means of such facility or equipment, including subscriber numbers, databases, signaling systems, and information sufficient for billing and collection or used in the transmission, routing or other provision of a telecommunications service. Section 153(a)(45).

This definition makes it clear that the LECs' unbundling obligations must be read broadly to include all features and functionalities that other carriers may require in order to provide competing telecommunications services. See also Section 252(d)(2)(B).

The unbundling obligation includes, but is not limited to, the unbundling of such physical elements as loops and sub-loop elements, switching capacity, signaling functions and capabilities, the LECs' logical networks, and the necessary administrative and operational support that must accompany provision of those elements. Administrative and operational support functions are important, because they will enable competitors to provide the same level of service quality as the underlying LEC's own retail customers will receive. It should be as easy for customers to switch local service providers as it is today for them to switch long distance companies. Without automated, nondiscriminatory operational support mechanisms, however, that cannot happen — and the availability of the LEC network to new entrants will be a nullity as a practical matter. As ALTS has persuasively argued, the Commission must require in its rules that such mechanisms be created by incumbent LECs immediately. It will not be enough to rely on general language requiring nondiscrimination.

B. Access at Cost

The plain language of the Act requires incumbent LECs to provide interconnection (access) to interexchange carriers at cost-based rates. Section 251(c)(2) provides an affirmative obligation on the part of the incumbent LEC to interconnect with any requesting telecommunications carrier for the transmission and routing of telephone exchange and exchange access service. We agree with ALTS that interconnection should allow for the exchange of all types of traffic.

A "telecommunications carrier" is defined as any carrier offering telecommunications service (except aggregators). Section 153(a)(49). By definition, then, a "telecommunications carrier" includes all carriers— whether offering long distance service, mobile service, or local exchange and exchange access (with the sole exception of "aggregators"). "Exchange access" is defined as the offering of access to telephone exchange services or facilities for the purpose of originating or terminating toll calls. Section 153(a)(40). Thus, Section 251(c)(2) includes interconnection between a telecommunications carrier's long distance network and an incumbent LEC's access network in order to originate and terminate toll calls, just as it includes the interconnection between a CLEC's facilities and an incumbent LEC.² Furthermore, as discussed in the following section, access must be provided at direct economic cost.

C. Pricing of Interconnection and Unbundled Network Elements

The Act requires that prices for interconnection (including access) and unbundled network

² In addition to the duty to interconnect, Section 251(c)(2) requires incumbent LECs to provide interconnection at any "technically feasible" point, and forbids the incumbent LEC from discriminating against any nonaffiliated carrier that seeks interconnection.

elements be "based on cost . . . of providing the interconnection or network element." The rate established may include a reasonable profit, and shall be nondiscriminatory. Section 252(d)(1). Section 251(c)(2) and (3) reference this cost standard. In defining cost, the Act provides that cost be determined "without reference to a rate-of-return or other rate-based proceeding." Id. This language requires economic-cost pricing, not traditional, fully distributed rate-of-return pricing.

There are two basic approaches to defining costs: (1) cost determined by fully-distributed, rate-base accounting, and (2) economic cost, reflecting the direct resource cost of providing a service or network element. In rejecting the former standard, Congress has effectively adopted the latter standard. Thus, under the Act, incumbent local exchange carriers are not entitled to charge other carriers (their direct competitors) rates that reflect all the accounting costs and profits that are used in a traditional rate-of-return or rate base proceeding. The provision in the federal statute that permits, but does not require, inclusion of a "reasonable profit", is entirely consistent with economic-cost-based pricing, and is indicative of Congress's intent that the Commission select a standard that best induces competition. See Section 252(d)(1)(B). Economic cost already includes a reasonable profit.

Federal legislation also makes clear that the same bottoms-up, cost-based pricing methodology must be used whether some or all network elements are purchased. Section 251(c)(3)(1996). The Commission should make this clear in its rules as well. Only if the LECs' competitors face the same cost structure when using the LEC network as the LECs themselves face will competitors be given the right incentives to build facilities that will provide a robust, competitive telecommunications marketplace for consumers. The Commission should adopt

economic cost because it is mandated by the statute and because it is the economically and competitively correct result.

D. Cost-Based Access and RBOC InterLATA Entry

Section 271 clearly contemplates that RBOC exchange access rates must be set at cost before the RBOCs can enter the in-region interLATA market. First, the competitive checklist of Section 271 makes it clear that the Section 251 and 252 requirements of cost-based rates for interconnection (including access) and unbundled network elements must be in place before any application for RBOC entry can be granted. Section 271(c)(2)(B).

Second, Section 271 requires that the RBOCs face maninful facilities-based competition before obtaining authority to provide in-region interLATA services. As a result, the Act clearly contemplates that, before the RBOCs may obtain in-region interLATA relief, their access rates must be subject to considerable market pressure.

Third, Section 271 also requires the Commission to determine that grant of an RBOC application to provide in-region interLATA service must be in the public interest. Section 271(d)(3)(C). This public interest test cannot be satisfied in an environment in which the RBOCs are receiving (and their competitors are paying) access charges that are many times cost. Not only is that an intolerable burden on those telecommunications companies that provide long distance while utilizing LEC-provided access, it produces anticompetitive market distortions and creates uneconomic price signals in the exchange access market. Creation of a system that allows some carriers to buy interconnection and network elements at cost, while others to buy out of access tariffs that are many times the LECs' economic costs, is not sustainable as a policy or legal

matter.

Thus, even if the RBOCs were correct in contending that Sections 251 and 252 do not require nondiscriminatory, cost-based access rates, the public interest test of Section 271 clearly does. It would be untenable for the RBOCs to begin to provide interLATA services, with their own access inputs at economic cost, while their direct competitors are paying many times that for the same input. Without a drop in access prices to cost, existing competition in the interLATA market could be substantially impeded and the Section 271 public interest test, therefore, could never be satisfied.

E. Resale of Retail Services

Section 251(c)(4) of the Act requires LECs to make available their retail services for resale by carriers. As in the case of unbundled network elements, the Commission should take steps to ensure that resold services can be offered by competitive carriers at the same level of quality as the underlying LEC's own retail customers will receive. To achieve this result, the Commission must include in its mandate for resale the offering of automated, nondiscriminatory operational support mechanisms. Under the Act, services are to be made available to carriers at "wholesale" rates, defined by the Act as the retail rate minus the "marketing, billing, collection, and other costs that will be avoided by the local exchange carrier." Section 252 (d)(3).

It is essential that the Commission distinguish between this "service resale" under Section 251(c)(4) of the Act, and the purchase of unbundled network elements that telecommunications carriers can combine, as provided under Section 251(c)(3) of the Act. While "service resale" will be an essential path to entry for many providers, it alone cannot form the basis for vigorous,

innovative competition and consumer choice in the local market. Service resale constrains carriers to mimic the LEC's own retail services. In contrast, the unbundled network element model, provided for under Section 251(c)(3) of the Act, permits carriers to employ the LEC network capabilities to craft their own innovative retail services, defining the features, calling areas, and pricing design of those services in such a way as to present attractive alternatives to the LEC's own offerings.

In implementing the Act, the Commission should keep in mind that Congress established network unbundling and service resale as two complementary avenues for new entrants to provide service without always first constructing their own local network. This has significant consequences for pricing. The "avoided cost" approach to pricing applies only to resale of end user offerings under Section 251(c)(4), and not to a carrier's purchase of a combination of unbundled network elements as provided in Section 251(c)(3). See Section 252(d)(3) (avoided cost pricing applies only to resale retail services under Section 251(c)(4)).

III. CONCLUSION

In implementing Sections 251 and 252 of the Act, the Commission must, among other things, take the following steps:

- order broad unbundling of LEC physical and logical network elements at any technically feasible point on terms and conditions that are just, reasonable, and nondiscriminatory;
- require LECs to offer these elements in a manner that permits other carriers to combine them to offer any telecommunications service;
- order LECs to provide interconnection (including exchange access) to telecommunications carriers at any technically feasible point;

- establish that the cost standard in Section 252(d)(1) shall be interpreted to mean direct economic cost; and
- require LECs to make retail services available for resale at wholesale rates.

By taking these actions, the Commission will take essential steps toward the creation of vigorous competition and wide consumer choice for all telecommunications services.